Core Elements of a Budget Plan

by Bernie Mapili, CPA, MST

Welcome to the 2013 budget season. Hopefully, this year will be the best budget year in quite some time. I have seen results of the economic recovery over the associations we audit, review, and compile, and the results are looking very promising. Short sales are getting offers in less than a day once on MLS, foreclosures filed from 2008–2010 are reaching closure, and association tenant demand letters are sending their rent payments to the association. The purpose of this article is to help the experienced CAM who has been battling the budget wars for a few years now. If this is your first year budgeting, please solicit the help of an experienced CAM, accountant, or other advisor to decipher the tips below to help your budget go from good to great! Also, there are many topics below where legal counsel is needed. Please remember every association has a unique set of governing documents, and you may need an attorney to understand what tips below you can utilize at your specific association.

Core Elements

The core elements of the budget plan consist of three sections: the operating expenses, the reserves, and lastly, revenue to pay for the two previous sections. The ultimate goal of a good budget is to prevent an increase in assessments by being savvy with any excess unallocated cash from the prior year plus member assessments and other revenue streams to be received.

Revenue aka "Member Assessments, Dues, Moolah"

In a traditional budget, revenue has simply been the leftover calculation. For example, a simple budget would have 100 homeowners with total annual combined expenses of $100,000. To calculate revenue, you would charge member assessments at $1,000 per homeowner to cover the total annual combined expenses. However, in 2013, member assessments are not the only revenue stream after all these years battling the economic downturn with nonpaying members. Some associations have increased the initial capital contributions of transfer ownership in the annual budget from $250 to $1,000. Some boards have pushed it further, and the initial capital contribution not only applies to the initial sale of a home but to every subsequent transfer in ownership down the road.

Other revenue streams mentioned earlier are short sales, foreclosures, and tenants that have their rent re-directed to the association until further notice. Short sales are open to collect everything owed to the association while foreclosure lawyers know how to navigate safe harbor provisions like a cruise ship captain parallel parking in Cape Canaveral. Lastly, your legal counsel has finally completed an association foreclosure, allowing you to rent the unit, or they can intercept tenant rent payment from those homeowner landlords who still refuse to pay their dues. Each homeowner account should be looked at individually to estimate when you might receive such revenue. This money has been on the table for many years now and many associations are finally able to collect it.

Below is an example of what your member assessments could look like under an ideal situation given the following assumptions:

Assumptions:

- 100 units in the association
- All reserves are fully funded
- Initial capital contributions—5 sales at $1,000/each. $5,000
- Short sale of Unit #123 . . . . $5,000
- Foreclosure of Unit #456 . . . . $2,500
- Tenant Rent $7,500
- Total other revenue $20,000

- Total annual combined expenses $100,000
- Needed member assessments to cover total combined expenses. $80,000
- Annual assessment per homeowner $800
- Simple budget assessment per homeowner $1,000
- Savings utilizing these non-traditional revenue streams $200

Therefore, over an annual basis, instead of paying the traditional budget example of $1,000 per homeowner, they only have to pay $800, which is a savings of $200 per homeowner. Now before you crack open the champagne, this is an ideal situation to highlight potential savings of each method. Each association should use the history of how long

foreclosures and short sales are averaging in your community, where you are in the association foreclosure process, and whether you have actually been successful in receiving rental payments. Some of you will do even better than my example!

Please keep in mind, there are many other real world factors I'm leaving out to simplify this example to these newer revenue streams. There are reserves to be funded as well as upsides, such as collecting violation fines, late fees, clubhouse profits, bank interest, etc.

Operating Expenses

Operating expenses keep your association running every year. There can be as little as 20 line items to more than 100 line items in this section alone. The overall tip of simply using an average of last year's actual expenses is not the best way to go on every line item. Over generalization will lead to budget blows and special assessments. Below are some bulleted key line items that need more than a last year's average to be on target:

- **Utility Bills—**Some utility providers send a letter with next year's incremental bill rates. If you have time, average your monthly consumption against their tier rate multipliers and you can better estimate your cost next year. If you're overwhelmed with all the information at this point, at least increase utilities 3–5 percent to cover inflationary price increase.
- **Landscape Replacements—**We had a warm winter this past year so many associations saved on this line item. However, 2010 was a very cold winter, and the 2011 budget paid for it. Do not simply copy and paste this past year's spending. Consider the past few winters, whether you planted cold-hardier plants, or do a winter landscape preparedness with your landscaper.
- **Insurance—**Check with your agent as those rates keep dropping! How low do they expect it to go? Bonus tip: consider the highest dollar amount of any one insurance deductible, which is typically a hurricane. This is a great place to park any extra cash other than reserves.
- **CPA Fees—**These should probably be higher. Just

kidding, not really... moving on.

- **Bad Debt Expense—**Look at your prior history to dictate how the market is dealing with your association's short sales and foreclosures. Generally speaking, most associations should have enough allowance built up from this year, so basically this elephant in the room will stay the same size elephant.

Reserves Expenses

The final core element of a budget plan is the reserves. The reserves are repairs and replacements of items with a useful life greater than a year and a cost greater than $10,000. Ideally, reserves are the easiest factor that should be the most consistent annually. In fact, a simple reserve plan of attack has an expected life of each asset to replace and the same dollar amount saved (aka reserved) each year to get to that expected replacement cost's value at that future year. For example, if your private roads resurfacing expected costs are $16,000 in eight years, then that is $2,000 a year in reserve.

A great reserve savings technique is to consider using the pooling method over the component method. But what is pooled versus component? At a high level, if you have a private road and a gate, then the pooled method allows you to reserve for all items in one combined account despite their separate useful lives and dollars. So when the road needs a facelift, you can use the pooled reserves to restore the road with whatever is in the combined reserve account at that time. Under the component method, you can only use the amount accumulated in the road reserve account, so you might have a special assessment or have to raise the budget to ramp up savings while your gate money is left untouched. For a more detailed analysis, a reserve study performed by a properly licensed engineering firm is a great way to go.

In conclusion, my goal is to get you from a good budget to a great one! Budget season can be stressful, but these tips provide ways to increase revenue streams and use better trend indicators to decrease poor budgeting. The end results should leave you in a position to consider a nominal increase or flat budget versus a mandatory increase. Good luck and God speed!

Bernie Mapili, CPA, MST, is Partner of Mapili CPAs, LLC, located in Winter Park, Florida. For more information, visit ***www.MapiliCpas.com****.* ■